

# Audit



# Report

OFFICE OF THE INSPECTOR GENERAL

**FINANCIAL REPORTING OF  
GOVERNMENT PROPERTY IN  
THE CUSTODY OF CONTRACTORS**

Report No. 97-202

August 4, 1997

**DISTRIBUTION STATEMENT A**  
Approved for Public Release  
Distribution Unlimited

**Department of Defense**

DTIC QUALITY INSPECTED 4

19991013133

AAI 00-01-0648

### **Additional Copies**

To obtain additional copies of this report, contact the Secondary Reports Distribution Unit of the Analysis, Planning, and Technical Support Directorate at (703) 604-8937 (DSN 664-8937) or FAX (703) 604-8932.

### **Suggestions for Future Audits**

To suggest ideas or to request future audits, contact the Planning and Coordination Branch of the Analysis, Planning, and Technical Support Directorate at (703) 604-8939 (DSN 664-8939) or FAX (703) 604-8932. Ideas and requests can also be mailed to:

OAIG-AUD (ATTN: APTS Audit Suggestions)  
Inspector General, Department of Defense  
400 Army Navy Drive (Room 801)  
Arlington, VA 22202-2884

### **Defense Hotline**

To report fraud, waste, or abuse, contact the Defense Hotline by calling (800) 424-9098; by sending an electronic message to [Hotline@DODIG.OSD.MIL](mailto:Hotline@DODIG.OSD.MIL); or by writing to the Defense Hotline, The Pentagon, Washington, DC 20301-1900. The identity of each writer and caller is fully protected.

### **Acronyms**

AAA	Army Audit Agency
AFAA	Air Force Audit Agency
CFO	Chief Financial Officer
CPMS	Contract Property Management System
DCMC	Defense Contract Management Command
DD	Defense Department
DFAS	Defense Finance and Accounting Service
DLA	Defense Logistics Agency
FAR	Federal Acquisition Regulation
GAO	General Accounting Office
MOCAS	Mechanization of Contract Administration Services
PA	Property Administrator
IPT	Integrated Process Team



**INSPECTOR GENERAL  
DEPARTMENT OF DEFENSE  
400 ARMY NAVY DRIVE  
ARLINGTON, VIRGINIA 22202-2884**



August 4, 1997

**MEMORANDUM FOR UNDER SECRETARY OF DEFENSE FOR ACQUISITION  
AND TECHNOLOGY  
UNDER SECRETARY OF DEFENSE (COMPTROLLER)  
ASSISTANT SECRETARY OF THE NAVY (FINANCIAL  
MANAGEMENT AND COMPTROLLER)  
ASSISTANT SECRETARY OF THE AIR FORCE  
(FINANCIAL MANAGEMENT AND COMPTROLLER)  
AUDITOR GENERAL, DEPARTMENT OF THE ARMY  
COMMANDER, DEFENSE CONTRACT MANAGEMENT  
COMMAND**

**SUBJECT: Audit Report on Financial Reporting of Government Property in the  
Custody of Contractors (Report No. 97-202)**

We are providing this report for review and comments. This is the first in a series of reports resulting from a joint audit with the Army, Navy, and Air Force audit organizations. No comments were received on a draft of this report.

Management is requested to provide comments on this final report that conform to the requirements of DoD Directive 7650.3. We should receive the comments by October 3, 1997.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Mr. Richard B. Bird, Audit Program Director, at (703) 604-9175 (DSN 664-9175) or e-mailed to [rbird@DODIG.OSD.MIL](mailto:rbird@DODIG.OSD.MIL). Questions may also be directed to Ms. Linda A. Pierce, Audit Project Manager, at (216) 522-6091, extension 234 (DSN 580-6091, extension 234) or e-mailed to [lap@DODIG.OSD.MIL](mailto:lap@DODIG.OSD.MIL). See Appendix G for the report distribution. The audit team members are listed inside the back cover.

*David K. Steensma*

David K. Steensma  
Deputy Assistant Inspector General  
for Auditing

## Office of the Inspector General, DoD

Report No. 97-202  
(Project No. 6FI-2009)

August 4, 1997

### Financial Reporting of Government Property in the Custody of Contractors

#### Executive Summary

**Introduction.** This report is one of a series of reports resulting from a joint audit related to requirements of the Chief Financial Officers Act of 1990, as amended by the Government Management Reform Act of 1994. In recent years, the Military Department audit agencies have not been able to express an overall opinion on the principal financial statements of the Army, the Navy, and the Air Force, partly because of uncertainty about the reasonableness of amounts reported as assets.

DoD has not gained adequate financial control and accountability over \$92 billion of Government property in the custody of contractors. After several years of planning, DoD has not developed a standard accounting system for recording, tracking, and reporting Government property in the custody of contractors. Until adequate DoD systems are working, DoD must develop a method of reporting in its financial statements the value of Government property in the custody of contractors.

**Audit Objectives.** The overall audit objective was to determine whether account balances for Government property in the custody of contractors were complete, accurate, and included in the financial statements of the Military Departments and Defense agencies. We also assessed management controls affecting the financial reporting of Government property, and we assessed compliance with applicable laws and regulations. This report addresses the use of the Contract Property Management System for financial reporting of Government property. Issuance of this report does not complete our announced audit objectives. We will issue a separate report on Government property reporting by Defense agencies, and a consolidated report that will include the results of work done by all Military Department audit agencies participating in the audit.

To accomplish the audit objectives, we reviewed data in the FY 1995 Contract Property Management System. Although FY 1996 data from the Contract Property Management System were not available at the time of our audit, the issues discussed in this report did not change from FY 1995 to FY 1996.

**Audit Results.** The Contract Property Management System does not meet DoD requirements for financial statement reporting. Therefore, the system cannot be relied on for reporting the value of Government property balances in the financial statements (Finding A). The use of Contract Property Management System data on DoD financial statements leads us to conclude that a DoD-wide material management control weakness exists for financial reporting of Government property in the custody of contractors. See Appendix A for a discussion of the material management control weaknesses.

The Contract Property Management System does not completely or accurately report Government property in the custody of contractors. As a result, the FY 1995 data we reviewed in the Contract Property Management System contained \$962 million in

aggregate errors, and DoD had no assurance that the remainder of the data were complete or accurate. In addition, in FY 1995, the Contract Property Management System reported about \$39.3 billion of military property, an increase of more than three times the amount reported in FY 1986. The increase is misleading. Approximately \$20 billion of the \$22 billion of military property we reviewed in the FY 1995 Contract Property Management System consisted of assets held by contractors for repair, maintenance, or overhaul; repairable secondary items; property accepted by the Government and stored by the contractor; and foreign military assets. In our opinion, the military property category should not include those types of assets (Finding B). We reviewed the adequacy of management controls over the Contract Property Management System. We identified a material management control weakness because the Defense Contract Management Command, Defense Logistics Agency, controls over the Contract Property Management System were not adequate to ensure that all contracts authorizing the use of Government property were identified, or all Government property was recorded in Contract Property Management System. See Appendix A for a discussion of the material management control weaknesses.

**Summary of Management Actions.** In February 1997, the Under Secretary of Defense for Acquisition and Technology established the Government Property in the Possession of Contractors Integrated Process Team (the Integrated Process Team). The Integrated Process Team reviewed problems in the administration of rules governing Government property, focusing on the reasons that Government property in the possession of contractors continues to increase; the transfer and disposal of Government property; and physical and financial accountability for Government property. The Under Secretary of Defense for Acquisition and Technology; the Under Secretary of Defense (Comptroller); the Military Departments; the Defense Contract Management Command, Defense Logistics Agency; and the audit community were represented on the Integrated Process Team. In June 1997, the Executive Review Group, established by the Integrated Process Team's charter, was briefed on proposed policies, procedures, and followup actions necessary to improve the physical and financial control of Government property provided to DoD contractors for contract performance. Although the Integrated Process Team recommended significant policy changes, it did not resolve the financial reporting problems. The Defense Contract Management Command recognizes the need to improve the Contract Property Management System and is considering other corrective actions.

**Summary of Recommendations.** We recommend that the Under Secretary of Defense (Comptroller) form a working group to develop solutions to the financial issues. We recommend that the Commander, Defense Contract Management Command, revise the Contract Property Management System to improve the accuracy, completeness, and timeliness of its data.

**Management Comments.** No management comments were received in response to the draft report. We request that management provide written comments on this report by October 3, 1997.

# Table of Contents

---

<b>Executive Summary</b>	<b>i</b>
<b>Part I - Audit Results</b>	
Audit Background	2
Audit Objectives	4
Finding A. Using CPMS for Financial Reporting of Government Property	5
Finding B. CPMS Controls for Completeness and Accuracy	13
<b>Part II - Additional Information</b>	
Appendix A. Audit Process	
Scope	20
Methodology	20
Management Control Program	21
Appendix B. Summary of Prior Coverage	23
Appendix C. Federal and DoD Regulations on Government Property	31
Appendix D. Categories of Government Property as Reported in CPMS	33
Appendix E. DD Form 1662, "DoD Property in the Custody of Contractors"	35
Appendix F. Topic Four, "Financial Accounting for Government Property in the Possession of Contractors"	37
Appendix G. Report Distribution	42

## **Part I - Audit Results**

### Audit Background

Financial management in DoD has improved, but progress is slow in areas such as the reporting of Government property in the custody of contractors. To understand the extent of the problems, it is important to review the basic requirements and concepts of Public Law 101-576, the "Chief Financial Officers [CFO] Act of 1990," as amended by the "Federal Financial Management Act of 1994;" Federal Accounting Standards; Government property in the custody of contractors; requirements for maintaining Government property records; Defense Department (DD) Form 1662, "DoD Property in the Custody of Contractors;" the Contract Property Management System (CPMS); Government property in the custody of contractors during the last 10 years; and property administration.

**The CFO Act and Federal Accounting Standards.** The "CFO Act of 1990" requires the annual preparation and audit of financial statements for trust funds, revolving funds, and substantial commercial activities of 23 Executive departments and agencies, as well as Government corporations. The CFO Act also requires the Inspectors General, or appointed external auditors, to audit financial statements in accordance with generally accepted Government auditing standards and other standards established by the Office of Management and Budget. Federal Accounting Standards are under development by the Federal Accounting Standards Advisory Board.

**Government Property in the Custody of Contractors.** The Federal Acquisition Regulation (FAR) defines Government property in the custody of contractors as property owned by or leased to the Government or acquired by the Government under the terms of the contract. Contractors are ordinarily required to furnish all property necessary to perform Government contracts. However, the Government may provide property to the contractor, or may allow the contractor to purchase property to complete the contract work when in the best interests of the Government. Specific types of property that are furnished to or acquired by contractors include:

- o real property, including land and other real property;
- o plant equipment, including industrial and other plant equipment;
- o special test equipment;
- o special tooling;
- o military property; and
- o material furnished to contractors by the Government and acquired by contractors for the Government.



In this report, "Government property" refers to all Government-owned property in the custody of contractors, whether furnished to contractors by the Government or acquired by contractors for the Government.

**Government Property No Longer a High-Risk Area.** The "Budget of the U.S. Government: Analytical Perspectives," chapter 24, "High Risk Areas," FY 1995, stated that DoD had made significant progress in strengthening controls and accountability over its contractors, and deleted controls over Government property as a high-risk area. DoD also stated that new regulations, guidance, and training programs had been implemented to increase administrative controls over contractors' use of DoD property.

**Requirements for Maintaining Property Records.** The FAR part 45, "Government Property," holds contractors accountable for Government property in their custody. Contractors are required to establish property control systems and maintain official Government property records. The FAR prohibits the Government from maintaining duplicate property records.

**DD Form 1662.** Contractors report Government property in their custody annually, using DD Form 1662, "DoD Property in the Custody of Contractors." A separate DD Form 1662 is submitted for each contract with Government property. The form lists nine categories of property: land, other real property, other plant equipment, industrial plant equipment, special test equipment, special tooling, military property, Government-furnished material, and contractor-acquired material. DoD personnel input the data from the DD Form 1662 into CPMS, which is maintained by the Defense Logistics Agency (DLA). See Appendix E for a sample DD Form 1662.

**Contract Property Management System.** The CPMS is an automated DoD system for capturing and maintaining data on property in the custody of contractors. The system was approved by the Defense Government Property Council in 1986 and gives an overview of Government property in the custody of contractors as of September 30 each year. Balances in each category of Government property are recorded by contract, based on physical inventories or property record balances in the contractor's property control system. The CPMS was designed to aid in maintaining property accountability and to give Congress an annual overview of Government property, not for reporting Government property on the financial statements. As stated in DoD testimony to the Senate Committee on Government Affairs in 1988, CPMS was intended to aid in achieving the DoD objectives of:

- o ensuring the proper use of all Government assets in the custody of contractors and DoD-operated plants;
- o ensuring that Government material is properly controlled and is not transferred from one contract to another without specific justification and authority; and
- o providing timely and useful management information regarding Government property in the custody of contractors.

## Audit Results

---

**Government Property in Contractors' Custody.** According to CPMS, the amount of Government property has increased over the last 10 years to about \$92 billion in FY 1995. Figure D-1, Appendix D, shows the changes during the last 10 years in each category of property. Figure D-2, Appendix D, shows the categories reported in CPMS as of September 30, 1995.

**Property Administration.** When Government property is authorized on a contract, a Property Administrator (PA) is assigned to administer contract requirements for Government property. The PA is responsible for:

- o evaluating the contractor's property control system,
- o reviewing the completeness and accuracy of management reports prepared by the contractor for the Government (including DD Forms 1662), and
- o ensuring that contractors properly use and account for Government property.

DoD 4161.2-M, "DoD Manual for the Performance of Contract Property Administration," December 1991, gives the policies and procedures for property administration.

## Audit Objectives

The overall audit objective was to determine whether the Government property account balances included in the financial statements for the Military Departments and Defense agencies were complete and accurate. We also assessed management controls affecting the financial reporting of Government property, and we assessed compliance with applicable laws and regulations.

This report addresses the use of CPMS for financial reporting. Issuance of this report does not complete our announced audit objectives. We will issue a separate report on Government property reporting by Defense agencies, along with a consolidated report that will include the results of work done by all Military Department audit agencies participating in the audit.

Appendix A discusses the scope and methodology of this audit and the management control program of the Defense Contract Management Command (DCMC), Defense Logistics Agency (DLA). See Appendix B for a summary of prior coverage related to the audit objectives.

---

## **Finding A. Using CPMS for Financial Reporting of Government Property**

The CPMS did not meet DoD requirements for financial statement reporting because the system was not designed to support financial statements. The CPMS:

- o duplicated assets reported in the general ledger accounts,
- o did not provide timely information,
- o did not apply capitalization thresholds, and
- o did not distinguish between assets of the general fund and the Working Capital Fund (formerly the Defense Business Operations Fund).

As a result, financial managers cannot rely on CPMS as an accurate source for reporting \$92 billion of Government property in the financial statements.

## **DoD Financial Management Regulation and Financial Statement Requirements**

To understand the extent of the problems with using CPMS to account for Government property, it is essential to review the DoD requirements for producing financial statements in accordance with the CFO Act and the Federal Accounting Standards.

DoD 7000.14-R, the "DoD Financial Management Regulation," volume 4, "Accounting Policy and Procedures," January 1995. DoD 7000.14-R requires accounting systems to list Government property data for each contractor and states that property accounting shall provide timely and reliable financial information. That Regulation also prohibits duplicative Government accounting records. Furthermore, DoD 7000.14-R requires that the DoD capitalization threshold be based on the funding threshold used by Congress to distinguish between investment and operating appropriations. The DoD threshold for operating expenses is \$100,000 for FY 1996.

DoD "Guidance on Form and Content of Financial Statements for FY 1996 Financial Activity," October 1996 (DoD Form and Content Guidance). The FY 1996 DoD Form and Content Guidance gives directions for preparing and presenting the FY 1996 financial statements required by the CFO Act. Beginning in FY 1996, DoD is required to prepare an agency-wide financial statement in accordance with the Government Management Reform Act of 1994. The nine reporting entities in DoD are the Departments of the Army, the

## **Finding A. Using CPMS for Financial Reporting of Government Property**

---

Navy, and the Air Force; the Working Capital Fund; the DoD Military Retirement Trust Fund; the National Defense Stockpile Transaction Fund; Other Defense Organizations; the U.S. Army Corps of Engineers (Civil Works); and the Defense Security Assistance Agency.

**Federal Accounting Standards.** The Office of Management and Budget, the General Accounting Office (GAO), and the Department of the Treasury are working to improve financial management practices throughout the Government by developing Federal Accounting Standards. Statement of Federal Financial Accounting Standards No. 6, "Accounting for Property, Plant, and Equipment," and No. 8, "Supplementary Stewardship Reporting," will be effective in FY 1998. These standards will change the way Government entities report Government property. Military property will be considered Federal mission assets and will be reported on the new supplementary stewardship reporting statement. The difference between reporting general property, plant, and equipment on the balance sheet and reporting Federal mission assets on the stewardship reporting statement is that capitalization thresholds will not be applied and depreciation will not be taken on Federal mission assets.

### **Military Departments Used CPMS to Report Government Property in the DoD Financial Statements**

During FYs 1994 and 1995, financial managers in each Military Department relied in part on CPMS data as a source of Government property balances for the financial statements.

**Army.** For the FY 1994 Army financial statements, the Army adjusted its general ledger accounts by \$5.6 billion to equal the \$15.5 billion reported in CPMS. For the FY 1995 statements, the Army did not adjust the general ledger accounts by \$7.4 billion to equal the \$15.7 billion reported in CPMS (excluding land and other real property) because a large number of Army-administered contracts were not updated in CPMS.

**Navy.** Although the Navy was not required to produce financial statements for FYs 1994 and 1995, it produced mock financial statements for FY 1995. The Navy used the data reported in CPMS to report \$34.8 billion of Government property on its mock financial statements for FY 1995. No adjustments to general ledger accounts were made.

**Air Force.** The Air Force used selected general ledger accounts and some data from CPMS to report Government property on the FYs 1994 and 1995 financial statements. However, the Air Force Audit Agency reported that the \$3 billion of Government property in the FY 1995 financial statements was \$23.6 billion less than the total Government property values reported by Air Force contractors in CPMS. The Air Force Audit Agency recommended that the Defense Finance and Accounting Service (DFAS) Denver Center use only CPMS data when reporting Government property. See Appendix B for further details.

## Finding A. Using CPMS for Financial Reporting of Government Property

---

### Using CPMS to Satisfy Financial Statement Reporting Requirements

Although CPMS is the only system that captures Government property data based on contractors' accountable records and inventories, it was not designed for accounting purposes and does not meet the requirements for financial statements. The CPMS is not adequate for reporting Government property balances on the financial statements because the system:

- o duplicates assets reported in the general ledger accounts,
- o does not provide timely data,
- o does not apply capitalization thresholds,
- o does not compute depreciation, and
- o does not distinguish between assets of the general fund and the Working Capital Fund.

**Duplicate Reporting.** Assets reported in the military property category of CPMS are duplicated in general ledger accounts. In the military property category, contractors report Government property that is peculiar to the mission of an agency and property that is sent to the contractor to be upgraded, repaired, or overhauled. We visited or contacted 35 contractors who reported \$22 billion in military property. About \$20 billion of that property included assets being repaired, overhauled, or in maintenance; repairable secondary items; shipped-in-place assets; and foreign military assets. Except for foreign military assets, contractors are correct in reporting those items in their custody as of September 30 each year. However, because the contractors are holding these assets for nonproduction use and will return them to the Government, the assets are often accounted for and reported through other DoD systems to the general ledger accounts. Therefore, using military property data from CPMS for financial statement reporting increases the risk of duplicate reporting of Government property. This problem exists in all of the Military Departments, as shown in the following examples.

**Army.** The FY 1995 CPMS reported 269 shipped-in-place tanks valued at \$1.4 billion. The Army accepted the tanks under a foreign military sales contract and should not have reported the tanks in the financial statements.

**Navy.** At a contractor-owned engine repair facility, we identified 52 Navy engines, valued at \$97.3 million, that were being repaired or shipped in place and reported in the FY 1995 CPMS. The same engines were also reported in the Navy Aircraft Engine Management System and would be counted again in the Navy financial statements if both systems were used as sources of financial data without adjustment.

## **Finding A. Using CPMS for Financial Reporting of Government Property**

---

**Air Force.** At one contractor facility, we identified six B-2 Bombers being upgraded or repaired that were reported in the FY 1995 CPMS at a total value of \$3.6 billion. The same six aircraft were also included in the Equipment Inventory Multiple Status and Utilization Reporting System, which provides the balance for Air Force general ledger account 141, "Aircraft, Complete," in the Air Force financial statements.

**Timeliness of Government Property Data.** Complete CPMS data on Government property were not available in time for preparation of the financial statements. Contractors must provide DD Forms 1662 to the PA annually, no later than October 31. However, no requirement specifies when DoD personnel must enter all DD Form 1662 data into CPMS. Because contractors did not always submit DD Form 1662 data promptly and entering data in CPMS was difficult, the FY 1995 data entry was not complete until mid-January, and the data were not available for use in preparing timely FY 1995 financial statements.

DFAS officials stated that data must be complete and provided to DFAS by December 8 each year for Government property balances to be included in version two of the financial statements. Version two is provided to DoD for auditing purposes. If Government property data are not complete before December 8, the Government property portion of the financial statements cannot be audited. The final version of the financial statements is due from DFAS on January 25 each year.

**Capitalization Criteria for Financial Statements.** The criteria for reporting high-value assets in financial statements differ from the criteria for including assets in Government property records. The FAR requires contractors to report Government property, regardless of dollar value. Since CPMS was not designed for financial statement purposes, the DD Form 1662 does not provide a capitalization threshold. Therefore, CPMS does not contain the data needed to determine how much Government property would remain after applying capitalization criteria. Applying the \$100,000 capitalization threshold to Government property would significantly reduce the amount reported on financial statements.

**Depreciation.** Government property assets that meet capitalization criteria must be depreciated for financial reporting purposes. The CPMS is a summary of Government property by category and does not provide the detailed information necessary to calculate depreciation on individual assets.

**Distinction Between General Fund and Working Capital Fund Assets.** CPMS data do not distinguish between assets of the general fund and the Working Capital Fund, and therefore do not comply with DoD guidance. In addition, CPMS does not give the value of property in each appropriation and does not contain adequate data for each fiscal year.

## **Finding A. Using CPMS for Financial Reporting of Government Property**

---

### **Conclusion**

DoD has not gained adequate financial control and accountability over Government property to meet the requirements of financial statements. Although some progress has been made, DoD has not developed a standard accounting system for recording, tracking, and reporting Government property. The DCMC, DLA, controls over the CPMS were not adequate to ensure that all contracts authorizing the use of Government property were identified, or all Government property was recorded in CPMS (see Finding B). The use of CPMS data on DoD financial statements leads us to conclude that a DoD-wide material management control weakness exists for financial reporting of Government property in the custody of contractors. Until a DoD standard financial system is implemented that meets the Federal Accounting Standards, DoD will not have accurate, complete, and auditable Government property balances in its financial statements.

Despite the problems with CPMS, the Military Departments and Defense agencies may continue using CPMS because it is the only system available or the best available. Even the best system, however, may not satisfy financial reporting requirements. The financial reporting of Government property is a DoD-wide problem that can be solved only through aggressive actions by managers in the acquisition, financial management, and logistics communities in DoD. On February 14, 1997, the Under Secretary of Defense for Acquisition and Technology formed the Government Property in the Possession of Contractors Integrated Process Team (IPT).

### **Management Actions: Government Property in the Possession of Contractors Integrated Process Team**

In March 1997, the Under Secretary of Defense for Acquisition and Technology convened the IPT. The IPT reviewed problems in the administration of rules governing Government property, focusing on:

- o the reasons that Government property in the possession of contractors continues to increase;
- o the transfer and disposal of Government property; and
- o physical and financial accountability for Government property.

The Under Secretary of Defense for Acquisition and Technology; the Under Secretary of Defense (Comptroller); the Military Departments; the Defense Contract Management Command, Defense Logistics Agency; and the audit community were represented on the IPT.

## **Finding A. Using CPMS for Financial Reporting of Government Property**

---

In June 1997, the Executive Review Group, established by the IPT charter, was briefed on proposed policies, procedures, and followup actions necessary to improve the physical and financial control of Government property provided to DoD contractors for contract performance. The IPT presented its conclusions and recommendations in four papers. Appendix F presents the complete text of the Topic Four paper, "Financial Accounting for Government Property in the Possession of Contractors," as presented to the Executive Review Group. In the paper, the IPT acknowledges that CPMS does not provide adequate information for audited DoD financial statements and does not recommend CPMS as a long-term solution to the financial reporting problem. However, the IPT does not propose a solution for the overall financial reporting problem -- how to get the data needed for the financial statements. The IPT makes recommendations on how the various categories of Government property in the possession of contractors should be reported on the financial statements. The following paragraphs discuss the issues presented in the Topic Four paper.

The IPT concludes that military property and real property are reported in DoD systems other than CPMS, and recommends that CPMS data not be used for financial reporting for those types of Government property. The Military Departments will need to validate the conclusion reached by the IPT, identify the systems that include military property and real property assets in the possession of contractors, and ensure that the data are properly reported in the financial statements.

The IPT recommends that Government-owned material in the possession of contractors be shown on the DoD financial statements as operating materials and supplies. The IPT does not address how DoD is to obtain information on this type of material for the financial statements, other than from CPMS.

The IPT considers plant equipment, special test equipment, and special tooling as one category--tooling and equipment. The IPT recommends that Government tooling and equipment used by contractors on contracts that are for general purposes, such as the operation of a Government plant or facility and base services, should be shown in "General PP&E" on the balance sheet of the DoD financial statements. The IPT further recommends that the tooling and equipment not used for base services or operation of Government plants or facilities be reported in the supplementary stewardship reporting statement as Federal Mission Property, Plant, and Equipment, or as a separate category. The IPT justifies this recommendation in part by stating, "One of DoD's objectives must be to implement the requirements of the CFO Act in such a way that non-value added expenditures of resources are avoided wherever possible." The IPT concludes that reporting the tooling and equipment on the stewardship statement will minimize or eliminate non-value added expenditures of resources on new property accountability and reporting systems that are needed to meet financial reporting requirements, but not to meet requirements of the Federal Property and Administrative Services Act or the FAR.

No policy memorandum addressing the Topic Four issues has been written. Because the IPT did not address all of the financial issues or initiate corrective



## **Finding A. Using CPMS for Financial Reporting of Government Property**

---

action to resolve the financial reporting problems, any implementing policy on the financial issues will be an incomplete solution. Therefore, we added the following recommendations to this audit report.

### **Recommendations for Corrective Action**

A.1. We recommend that the Under Secretary of Defense (Comptroller) form a working group to review the conclusions of the Government Property in the Possession of Contractors Integrated Process Team in the financial area, and develop short-term and long-term solutions to the financial accountability and reporting problems regarding Government property in the possession of contractors. The Under Secretary of Defense (Comptroller) should require participation in the working group by the acquisition and logistics communities, the Military Department financial organizations, the Inspector General, DoD, the Defense Finance and Accounting Service, the Defense Contract Management Command, and any Defense agencies with Government property in the possession of contractors. The goals of the working group should include:

a. Develop policy for reporting Government property in the possession of contractors on financial statements. Consider the recommendations of the Integrated Process Team and follow up with other organizations such as the Federal Accounting Standards Advisory Board to reach final policy decisions.

b. Identify the Government property in the possession of contractors that is not already reported for financial statement purposes through existing Military Department or DoD systems.

c. Develop a plan for collecting and reporting the information on Government property in the possession of contractors that is required for auditable financial statements but is not already included in an existing DoD system.

d. For Government property in the possession of contractors that is already reported in existing DoD systems, determine whether that property should be reported in special subsidiary accounts for Government property in the possession of contractors, or included in the accounts of the owning organization along with its Government property in the possession of the Government.

e. Determine how to present existing Government property when financial statements cannot be fully audited and opinions cannot be issued regarding the accuracy of the information on the statements.

f. Provide guidance for including Government property in the possession of contractors on DoD financial statements until a new policy and system are implemented.

## **Finding A. Using CPMS for Financial Reporting of Government Property**

---

g. Determine how to distinguish between Government property in the possession of contractors that should be reported on financial statements of the General Fund and the Working Capital Fund. Develop policy and implementing guidance on the solution.

A.2. We recommend that the Under Secretary of Defense (Comptroller) report the financial reporting of Government property as a DoD material weakness in the FY 1998 DoD Annual Statement of Assurance.

A.3. We recommend that the Secretary of the Army, the Secretary of the Navy, and the Secretary of the Air Force identify the systems in each Military Department that include Government property in the custody of contractors, determine whether that information is included in data reported for the financial statements, and report that information to the respective Military Department Comptrollers and to the DoD Chief Financial Officer.

---

## Finding B. CPMS Controls for Completeness and Accuracy

The CPMS did not completely or accurately report Government property for FY 1995. Controls were not established to identify all contracts that authorized the use of Government property, or to ensure that all Government property was recorded in CPMS. In addition, personnel responsible for entering data in CPMS did not receive adequate guidance or training in the use of CPMS. As a result, the FY 1995 CPMS data that we reviewed for \$12 billion of Government property contained about \$962 million in aggregate errors. DoD had no assurance that the remainder of CPMS data were complete or accurate.

### CPMS Data in FY 1995

The FY 1995 CPMS reported \$92 billion of Government property. We compared the data on 1,831 DD Forms 1662, reporting about \$12 billion of Government property, to information in the FY 1995 CPMS. We identified about \$962 million in aggregate errors. The following table summarizes the errors.

#### Errors in the FY 1995 CPMS

<u>Reason for Error</u>	<u>Number of Contracts</u>	<u>Aggregate Value of Errors (millions)</u>
<b>Completeness</b>		
Contracts not Reported in CPMS	134	\$227
<b>Accuracy</b>		
Incorrect Information Reported in CPMS	27	278
Contracts not Removed From CPMS	8	19
Incorrect Data Entered in CPMS	<u>68</u>	<u>438</u>
<b>Total</b>	<b>237</b>	<b>\$962</b>

### Completeness of CPMS Data

The CPMS did not have the controls necessary to ensure the complete reporting of Government property. Not all DD Forms 1662 submitted by contractors

## **Finding B. CPMS Controls for Completeness and Accuracy**

---

were entered in the FY 1995 CPMS. Also, we could not determine whether all contracts that included Government property had been identified and whether DD Forms 1662 had been submitted for all contracts.

**DD Form 1662 Data in CPMS.** The CPMS data were not complete because PAs failed to enter DD Forms 1662 entirely. We compared copies of DD Forms 1662 to the FY 1995 CPMS and determined that 134 contracts, including \$227 million of Government property, were not reported in the system. For example, at the Defense Contract Management Command (DCMC) Clearwater, Clearwater, Florida, at least 70 DD Forms 1662, showing \$88 million of Government property, were not entered into CPMS. The PA at DCMC Clearwater was responsible for more than 400 contracts that included Government property, but did not know that he should enter DD Form 1662 data in CPMS. When the PA learned that the data should be entered, he assigned an untrained clerical employee to the task. The PA did not detect the omissions because he did not know how to use CPMS reports to check CPMS data against the DD Forms 1662. PAs should use reports available from CPMS to verify that all DD Forms 1662 are correctly entered and accepted by CPMS.

**Identifying Contracts That Include Government Property.** PAs did not have an accurate method of identifying all contracts that include Government property. We interviewed PAs who relied on contractors' integrity and DD Forms 1662 to identify contracts that include Government property. Other PAs used the DCMC Property Administration Data System within the Mechanization of Contract Administration Services (MOCAS) system to identify contracts administered by DCMC that include Government property. MOCAS is an automated system used by contract administration offices to administer DoD contracts. The DCMC Property Administration Data System identifies contracts that include Government property clauses. We did not assess the accuracy of the DCMC Property Administration Data System or the MOCAS system in this audit. However, IG, DoD, audit (Report No. 95-046, "Data Input Controls for the Mechanization of Contract Administration Services System," November 30, 1994), reported that controls over automated data input to MOCAS were not adequate to prevent, detect, or correct erroneous data entry. Although a property clause in a contract does not guarantee that Government property has been assigned to that contract, a list of such contracts could be helpful in identifying contracts that include Government property but were not reported to CPMS. Each year, PAs should review contracts that have property clauses, but no CPMS entry, to determine whether the contracts included Government property as of September 30. The PAs should require the submission of DD Forms 1662 for all contracts including Government property.

## **Accuracy of Government Property Data Entered in CPMS**

The CPMS contained errors because PAs had not updated Government property data, had not deleted completed contracts, and had incorrectly entered data from DD Forms 1662 in CPMS. Out of 1,831 CPMS contracts reviewed, we identified 103 contracts with aggregate errors of about \$735 million.

## **Finding B. CPMS Controls for Completeness and Accuracy**

---

**Updating Data on Contracts in CPMS.** For 27 contracts in CPMS, PAs did not enter DD Form 1662 data for FY 1995. The errors on the 27 contracts totaled about \$278 million. For example, at DCMC Raytheon-Burlington, Burlington, Massachusetts, the PA assistant attempted to enter \$1,972 of material reported by the contractor under contract F05604-94-C-9004. CPMS would not allow the PA assistant to enter the DD Form 1662 data using the assigned code for contractor and Government entity because another entry had already been made for the same contract using a different code. The PA assistant could not overcome the system's rejection of the data. As a result of the rejections, \$248 million of Government property was incorrectly reported in the FY 1995 CPMS. Personnel responsible for entering data in CPMS must be trained in its use so they will know what actions to take when the system rejects legitimate data.

**Removal of Completed Contracts From CPMS.** PAs did not remove completed contracts from CPMS after contractors returned property to the Government. These types of errors occurred in eight completed contracts totaling about \$19 million. For example, at DCMC Birmingham, Birmingham, Alabama, the PA reported \$10 million of Government property on one contract in the FY 1994 CPMS. During FY 1995, the contractor properly disposed of the property and submitted a DD Form 1662 showing a zero balance. The contract was not closed in the FY 1995 CPMS because the original DD Form 1662 with a zero balance was not entered into CPMS. As a result, the \$10 million of Government property was erroneously carried over from FY 1994 to FY 1995. The DCMC should instruct PAs to remove completed contracts from CPMS.

**Data Entry.** Errors in entering DD Form 1662 data in CPMS accounted for about \$438 million of errors on 68 contracts. The largest error occurred at DCMC Lockheed Martin-Orlando, Orlando, Florida. The PA did not enter in CPMS the \$320 million of material that the contractor reported on the DD Form 1662. The PA attributed the error to incorrect data entry. Proper training in the use of CPMS could have prevented many of these errors, and electronic data interchange may also prevent errors.

**Use of Electronic Data Interchange to Improve CPMS Accuracy.** Electronic data interchange could improve the accuracy of CPMS by minimizing the data entry required. Electronic data interchange is the computer-to-computer exchange of routine business information in a standard format. Contractors could enter DD Form 1662 data in CPMS electronically and eliminate the need for manual entry by PAs. The risk of error is reduced each time a data entry requirement is eliminated, and the timeliness of the information improves as well. DFAS is working to make all major systems capable of electronic data interchange. Electronic data interchange would:

- o streamline the reporting process for DD Forms 1662,
- o reduce data entry errors, and
- o improve the accuracy of CPMS.

## **Military Property as Reported in CPMS**

The military property reported in CPMS includes items not used by contractors in performing Government contracts. About \$20 billion of the \$22 billion of the military property we reviewed in the FY 1995 CPMS consisted of assets held by contractors for repair, maintenance, or overhaul; repairable secondary items; property accepted by the Government and stored by the contractor (shipped-in-place); and foreign military assets. The CPMS reflects an upward trend in military property in the custody of contractors. In FY 1995, CPMS reported about \$39.3 billion of military property, an increase of more than three times the amount reported in FY 1986 and 43 percent of all reported Government property in FY 1995. Appendix D shows the amount of Government property reported by DoD contractors as of September 30, 1995, and the trend during the last 10 years. In our opinion, the military property category should not include assets being held for repair, maintenance, or overhaul; repairable secondary items; property shipped-in-place; and foreign military assets. The CPMS was designed to provide information on Government property that contractors use to perform Government contracts. According to CPMS, Government property has more than doubled since FY 1986. The increase is misleading. If the military property category in CPMS excluded such assets, CPMS would show less Government property and would present a more accurate overview of Government property held by contractors for contract performance.

## **Guidance and Training for PAs**

Personnel responsible for property administration did not receive adequate guidance and training in the use of CPMS. As a result, PAs had difficulty using CPMS to report Government property.

**CPMS Guidance.** The DCMC did not give DoD property personnel adequate guidance in the use of CPMS. We interviewed employees who entered the DD Forms 1662 for FY 1995. All of the employees stated that CPMS was not user-friendly. The system was slow, tended to shut down without warning, provided limited access, and had complex requirements for data entry. We asked for a current CPMS user manual, but the only manual was dated March 1989. The PAs were relying on electronic messages for updated guidance. This lack of published guidance increased the difficulty of entering DD Form 1662 data into CPMS and contributed to the \$962 million in aggregate data errors we identified. The DCMC should update and distribute the CPMS manual to all PAs and other employees who enter information in CPMS.

**CPMS Training.** The DCMC had not established a formal training program to instruct PAs on how to use CPMS or give them updated information on changes. PAs did not know how to access and use the reports available from CPMS to perform the property management mission. None of the PAs we interviewed had any formal CPMS training. Many of the problems with

## **Finding B. CPMS Controls for Completeness and Accuracy**

---

completeness and accuracy of CPMS data are attributable to this lack of training. The DCMC should develop a standard CPMS training course and require all personnel responsible for CPMS data entry to attend the course.

### **Conclusion**

We identified a material management control weakness because the DCMC controls over the CPMS were not adequate to ensure that all contracts authorizing the use of Government property were identified, or all Government property was recorded in CPMS. See Appendix A for a discussion of the material management control weaknesses. Although we identified problems with CPMS, it is the only DoD system that reports Government property. If complete and accurate, CPMS could provide management with a useful tool to monitor Government property and provide information for financial statements. Although CPMS is not a financial system (as discussed in Finding A), its data may be the most accurate information currently available for certain categories of Government property. The DCMC should improve CPMS by establishing controls over reporting and data entry requirements, and by updating user manuals and training programs. We did not make recommendations in the draft of this report because of the IPT that was addressing Government property issues. That effort did not address the issues discussed in this finding of our report, therefore, we are adding recommendations to this final report. As we do so, we acknowledge the initiatives of DCMC. Management comments may be included in a future report consolidating the results of the joint audit by the Army, Navy, Air Force, and Inspector General, DoD, audit organizations.

### **Management Actions: Operational Redesign of CPMS**

The management of DCMC recognizes the need to redesign the CPMS to allow contractors to send the required data electronically, and to develop user and system manuals, and to provide training for CPMS users. As a result, DCMC has developed an operational requirements document that acknowledges the shortcomings of the CPMS, identifies the capabilities the CPMS should have, and specifies program support requirements. DCMC has also initiated actions to improve the performance of the CPMS. We support those actions which will improve property management and provide more accurate and timely management information.

## **Recommendations for Corrective Action**

**B.1. We recommend that the Commander, Defense Contract Management Command:**

a. Complete the redesign of the Contract Property Management System in accordance with the Operational Requirements Document, to include enabling contractors to send data electronically, developing user and systems manuals, and providing training to users; and

b. Require property administrators to use the Defense Contract Management Command Property Administration Data System to identify contracts with Government property.

**B.2. We recommend that the Under Secretary of Defense for Acquisition and Technology revise reporting milestones to make the annual Contract Property Management System data available by November 15 of each year.**



## **Part II - Additional Information**

---

## **Appendix A. Audit Process**

### **Scope**

To accomplish the audit objectives, we reviewed \$12 billion of \$92 billion of Government property that was reported on 1,831 of 18,900 contracts in the FY 1995 CPMS. In addition, we visited or contacted 35 contractors who reported \$22 billion of military property. We interviewed Government and prime contractor personnel, and we evaluated the procedures, controls, and processes used to report data on Government property from prime contractors' property control systems to CPMS. We did not review subcontractors' property control systems because the Government does not have a direct contractual relationship with subcontractors. The prime contractor is responsible for reporting the Government property in the custody of its subcontractors. We limited our review to assessing CPMS as a source for financial reporting. We included tests of management controls considered necessary to accomplish the audit objectives.

### **Methodology**

We coordinated our audit efforts with the Military Department audit agencies to obtain broader coverage of the audit objectives. The Military Department auditors reviewed the use of CPMS as a source for financial reporting of Government property on contracts for each Department. We provided initial guidance on the scope of the effort, and arranged for training in Government property at the Air Force Institute of Technology for auditors of the IG, DoD, Military Department auditors, and DFAS personnel. Throughout the project, we held joint planning and briefing sessions with the Military Department auditors, allowing them to share ideas, audit approaches and methodologies, and audit results. Each Military Department is issuing its own audit report. We are coordinating the reporting process in anticipation of a consolidated report to be prepared by the IG, DoD.

We used computer-processed data from CPMS to perform the audit. Finding B discusses the accuracy and completeness of those data. We did not use statistical sampling procedures to perform the audit. Although FY 1996 CPMS data were not available at the time of our audit, the issues discussed in this report did not change from FY 1995 to FY 1996. CPMS does not meet the reporting requirements for financial statements, and management controls over CPMS have not been modified. We expect errors similar to those identified in our review of FY 1995 CPMS data to occur in the FY 1996 CPMS.

We performed this financial-related audit during the period April 1996 through January 1997. This audit was made in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD.

**Contacts During the Audit.** We visited or contacted individuals and organizations within the DoD. We also visited DoD contractors. Further details are available on request.

### Management Control Program

DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987,\* requires DoD organizations to implement a comprehensive system of management controls that provides reasonable assurance that programs are operating as intended and to evaluate the adequacy of the controls.

**Scope of Review of the Management Control Program.** We reviewed the management control program at the DCMC. The CPMS was not an assessable unit in the management control program; therefore, management did not perform self-evaluations in this area.

**Adequacy of Management Controls.** We identified material management control weaknesses for the DCMC, as identified by DoD Directive 5010.38. The DCMC controls over the CPMS were not adequate to ensure that all contracts authorizing the use of Government property were identified, or all Government property was recorded in CPMS (see Finding B). The DCMC officials did not identify or report the material management control weaknesses identified by the audit because controls over the CPMS were not an assessable unit.

The use of CPMS data on DoD financial statements leads us to conclude that a DoD-wide material management control weakness exists for financial reporting of Government property in the custody of contractors. The results of the joint audit efforts by the Army, Navy, Air Force, and IG, DoD, audit organizations support that conclusion (see Finding A). Complete results of the joint audit effort will be consolidated in a future report. Recommendation A.1. in this report, if implemented, will assist DoD in correcting the material weakness. A copy of this report will be provided to the senior official responsible for management controls at the Office of the Under Secretary of Defense (Comptroller).

---

\*DoD Directive 5010.38 has been revised as "Management Control Program," August 26, 1996. This audit was performed under the April 1987 version of the Directive.

## Appendix A. Audit Process

---

**Actions Planned by DCMC.** The management of DCMC plans to update and revise the CPMS. Areas to be addressed include allowing contractors to send required data electronically to the CPMS, developing user and system manuals, and providing training for users. We believe the DCMC actions will address many of the problems identified in this report and will improve CPMS. A copy of this report will be provided to the senior official responsible for management controls at the DCMC.

---

## **Appendix B. Summary of Prior Coverage**

The complete and accurate reporting of Government property has been a long-standing problem throughout DoD. During the last 5 years, the GAO; the IG, DoD; the Army Audit Agency; and the Air Force Audit Agency have issued reports on the financial reporting of Government property.

### **General Accounting Office Reports**

Report No. AIMD-96-7 (OSD Case No. 1050), "Chief Financial Officers Act Financial Audits: Increased Attention Must Be Given to Preparing Navy's Financial Reports," March 27, 1996, concluded that the Navy had made little progress in improving the financial management and reporting for its general funds since the passage of the CFO Act. The GAO identified a minimum of \$225 billion of errors (including \$8 billion of Government-furnished and contractor-acquired material that was counted twice) in the Navy FY 1994 consolidated financial statements. The cause of the deficient financial reporting by the Navy was failure to use basic internal controls and install discipline in financial operations. The GAO made recommendations to the Under Secretary of Defense (Comptroller) and the Assistant Secretary of the Navy (Financial Management and Comptroller) for joint actions to improve the credibility of the Navy financial reports. DoD generally concurred with the findings and recommendations.

Report No. AIMD-94-136 (OSD Case No. 9804), "Office of Management and Budget's High-Risk Program: Comments on the Status Reported in the President's FY 1995 Budget," September 20, 1994, evaluated the Office of Management and Budget's high-risk program for the President's FY 1995 budget. The Office of Management and Budget deleted 26 areas from its high-risk list, including administrative controls over DoD property in the custody of private contractors. The GAO disagreed with this deletion, stating, "While DoD has taken some actions, inadequate controls over DoD property in the custody of private contractors is a long-standing problem that has not been corrected to the point that it should be deleted from the Office of Management and Budget's high-risk program."

Report No. AIMD-93-1 (OSD Case No. 9276-E), "Examination of the Army's Financial Statements for FYs 1992 and 1991," June 30, 1993, stated that conditions found in FY 1991 were continuing. The GAO report on the Army FY 1991 financial statements identified a number of conditions preventing the GAO from expressing an opinion on the statement of financial position. The GAO audit for FY 1992 compared the FY 1991 findings with current conditions and reported that controls over contractor-held property were still not in place.

Report No. AFMD-92-82 (OSD Case No. 8674-L), "Immediate Actions Needed to Improve Army Financial Operations and Controls," August 7, 1992,

## Appendix B. Summary of Prior Coverage

---

presented the results of the Army financial management operations for FY 1991. The GAO found that although the Army has worked to improve its accounting systems since 1983, operations and systems did not provide reliable financial data. The GAO identified multiple uncertainties and discrepancies and was unable to express an overall opinion on the Army financial statements. For property furnished to contractors, the auditors identified differences totaling about \$11.3 billion between the Army Materiel Command's records and contractors' records. Army officials did not research the discrepancies, but removed the property from the accounts. DoD partially concurred with the GAO finding that conventional ammunition inventory systems did not provide accurate data.

Report No. AFMD-92-61 (OSD Case No. 8674-K), "Weak Financial Accounting Controls Leave Commodity Command Assets Vulnerable to Misuse," September 4, 1992, addressed internal control weaknesses in the accountability and control over resources at selected commodity commands. The review was made in conjunction with the review of the consolidated Army financial statements required by the CFO Act. Amounts reported by contractors for Government-furnished material differed by \$1.4 billion from the amounts reported by three commands. About \$1.1 billion of differences in Government-furnished equipment were partially caused by two commands' lack of accounting control over Government-furnished equipment. The GAO recommended that balances reported by contractors be periodically reconciled with DoD general ledger account balances. DoD concurred, stating that the DoD Form and Content Guidance for reporting FY 1992 financial activity would address the requirement to reconcile balances reported by contractors with DoD general ledger accounts.

Report No. AFMD-92-12 (OSD Case No. 8376-L), "Aggressive Actions Needed for Air Force to Meet Objectives of the Chief Financial Officers Act," February 19, 1992, followed up on the progress made by the Air Force and DoD in implementing the recommendations in a February 1990 GAO report. The Air Force and DoD had made only limited progress in implementing the previous recommendations. The Air Force system of internal controls did not adequately safeguard all assets or ensure that account balances and financial reports were reliable. The Air Force inventory records and accounts did not accurately portray the quantities and values of investment item inventories at Air Logistics Centers. The weaknesses resulted in substantial unnecessary costs to the Air Force and contributed to the \$11 billion of unrequired inventory reported by the Air Force as of September 30, 1990. DoD generally concurred with the findings and recommendations of the GAO. DoD had taken actions or planned to address the internal control weaknesses and inaccurate financial reporting discussed in the report.

## Inspector General, DoD, Reports

Report No. 96-212, "Capitalization of DoD General Property, Plant, and Equipment," August 19, 1996, stated that DoD Components, in accounting for

assets, capitalized and retained in the financial records low-cost items that were below the current capitalization threshold. The report recommended that a single capitalization threshold be applied to DoD general property, plant, and equipment assets (excluding the Working Capital Fund accounts) and that all items valued under that threshold be purged for the purposes of financial statement reporting. The Deputy CFO, Office of the Under Secretary of Defense (Comptroller), agreed that the recommendation had merit, but stated that corrective action should be deferred until the Office of Management and Budget issued guidance to implement new policies on property, plant, and equipment in financial statement reporting.

Report No. 95-301, "Major Deficiencies Preventing Auditors From Rendering Audit Opinions on DoD General Fund Financial Statements," August 29, 1995, stated that two major deficiencies that prevented auditors from rendering audit opinions on Army and Air Force general fund financial statements were the lack of adequate accounting systems and assets that were not reported adequately or valued properly. Several of the deficiencies were property issues, such as:

- o reporting construction-in-progress;
- o validating and reconciling property records;
- o estimating and crosswalking Government-furnished property;
- o adjusting the general ledger for Government-furnished property;
- o expensing Government-furnished materials as consumables; and
- o reporting real property assets of the Working Capital Fund.

The report did not contain recommendations because prior reports had addressed the same issues. Management agreed with the facts and conclusions in the report.

Report No. 95-046, "Data Input Controls for the Mechanization of Contract Administration Services System," November 30, 1994, concluded that internal controls were inadequate over:

- o automated data input to MOCAS;
- o the correction and reentry of data rejected at initial input; and
- o user access.

The report recommended the use of the Military Department edit and validation tables in MOCAS as controls over data accuracy, and the use of automated controls for the data input fields that accepted invalid data. The Deputy Comptroller (Financial Systems) partially concurred, stating that many MOCAS fields identified as having inadequate controls over automated edit or validation were programmed with minimal validations to provide flexibility for future changes. However, management agreed that additional edits and validations

## Appendix B. Summary of Prior Coverage

---

might be needed for several fields and stated that, for those fields, system changes would be reviewed and implemented as appropriate. The report also recommended:

- o issuing guidance on MOCAS reject listings;
- o updating desk procedures for handling automated reject listings;
- o increasing the number of supervisory reviews; and
- o implementing controls to ensure that user identifications were promptly canceled when no longer needed.

The Deputy Comptroller (Financial Systems) concurred with the recommendations.

Report No. 94-073, "Defense Finance and Accounting Service Work on the Air Force FY 1992 Financial Statements," March 31, 1994, concluded that the DFAS Denver Center did not prepare complete, accurate, and reliable FY 1992 Air Force financial statements. The DFAS Denver Center did not validate the accuracy of data on construction-in-progress and did not adhere to Air Force guidance on Government-furnished material and contractor-acquired material when preparing the financial statements. As a result, the accuracy of the \$24 billion shown on the financial statements for construction-in-progress could not be verified. The report recommended that the Director, DFAS Denver Center, develop and implement changes in internal guidance to conform to DoD and Air Force regulations on the reporting of Government-furnished material and contractor-acquired material in Air Force records. The DFAS Denver Center nonconcurred with the recommendation, responding that the general ledger accounts used for the Air Force General Fund were correct and were related to the Government-furnished material and contractor-acquired material accounts in the DoD Uniform Chart of Accounts. The DFAS Denver Center also stated that the source for reporting Government-furnished material was CPMS, which DLA maintained. The comments stated that Government-furnished material and contractor-acquired material were recorded in incorrect accounts. The comments were partially responsive. The DFAS Denver Center is currently working with IG, DoD staff to develop system capabilities which will address many major concerns cited in the audit report.

Report No. 93-037, "Government Property in the Custody of Contractors," December 17, 1992, evaluated the DoD implementation of 1986 property initiatives related to Government property in the possession of contractors, and assessed the effectiveness of internal controls over the property initiatives. The report concluded that material internal control weaknesses continued to exist over the management of Government property in the possession of contractors. As part of the review of property initiative number 27, the IG, DoD, tested the reliability of computer-generated data from DD Forms 1662. Minor problems were found with the accuracy of the property data reported on DD Forms 1662.



## Army Audit Agency Reports

Report No. CR 94-204, "Government-Furnished Property," March 31, 1994, stated that commodity commands did not have adequate management oversight for Government-furnished property. The Army Audit Agency (AAA) found that commodity commands did not:

- o use the annual summary report of DD Form 1662 as a management tool;
- o justify their decisions to provide material to contractors;
- o document property that was furnished to contractors;
- o have adequate control and visibility over direct shipments of Government-furnished material between contractors; and
- o promptly redistribute or dispose of property after contracts were completed.

The AAA made recommendations to develop policies and procedures to address the problems identified above. The procedures would require commands to:

- o compare their records of contracts that include Government-furnished property to the annual summary report of DD Forms 1662;
- o monitor the status of Government property on completed contracts;
- o ensure that all contractors who receive property submit DD Forms 1662 annually; and
- o maintain a list of contracts that include Government-furnished property.

The Office of the Assistant Secretary of the Army concurred with all recommendations and stated that an Army working group on Government-furnished property would begin action by December 31, 1994. Management was concerned about the accuracy of data in CPMS because:

- o the Army had no control over CPMS, and DoD had not established any requirement or time frame for entering DD Form 1662 data into CPMS;
- o no requirement existed for entering data on Government-furnished property in CPMS at the time of contract award; and
- o the instructions for reporting property on DD Form 1662 were not comprehensive, and not all property was covered (for example, work-in-process was not included). Also, it was not clear whether a DD Form 1662 was required if the Government maintained the official property records.

## Appendix B. Summary of Prior Coverage

---

Report No. CR 93-216, "Financial Accounting for Government-Furnished Property," June 28, 1993, evaluated the commodity commands' implementation of the GAO recommendations for improving financial accountability over Government-furnished property. The AAA agreed with the GAO assessment, but stated that the recommendations were long-term and could not be fully implemented because existing commodity command systems were not capable of integrating financial, logistical, and acquisition processes. Integration of the processes would require extensive and costly system changes. The AAA believed that starting such a long-term effort would not benefit the Army because DoD was implementing a new standard accounting system for the Military Departments. The AAA recognized that until the new system was developed, the Army needed a method of reporting Government-furnished property in its financial statements. The AAA concluded that because contractors maintained the official Government property records, the Army should adjust its general ledger accounts for material and equipment in the possession of contractors to match the value of property reported on the DD Form 1662. To use balances reported by contractors, the Army needed to:

- o establish a date when the Army needed information from CPMS in order to adjust the financial statements;

- o coordinate with DLA to ensure that CPMS could meet the time frame;
- and

- o require Army commands and activities to verify annually that all contractors with Government-furnished property submit DD Forms 1662.

The AAA also recommended that the Army:

- o request that DFAS eliminate the requirement to reconcile general ledger accounts for Government-furnished property to contractor-reported balances until DoD establishes a standard accounting system;

- o direct the Army Materiel Command to stop work on the system change request to record consumption data in the Commodity Command Standard System; and

- o coordinate with Army and DoD activities to determine the feasibility of allowing commodity commands to expense consumable material furnished to contractors.

The Office of the Assistant Secretary of the Army (Financial Management and Comptroller) agreed with the recommendations, but stated that approval from the Deputy Secretary of Defense was required before corrective actions could be taken on most recommendations.

## Air Force Audit Agency Reports

Project 96053011, "Review of Government-Furnished Property, FY 1995 Air Force Consolidated Financial Statements," October 22, 1996, concluded that the accuracy of Government-furnished property balances in the financial statements could not be confirmed because the Air Force did not have a system for recording, tracking, and reporting Government property. Further, balances reported in the financial statements were a net \$23.6 billion less than Government-furnished property values that contractors reported to DLA. The report also stated that in the absence of an acceptable Air Force reporting system, CPMS provided DoD with the most accurate information available on Government-furnished property. However, the report noted that CPMS duplicated Government-furnished property reported in other Air Force general ledger accounts (auditors identified \$10.4 billion of equipment reported in CPMS that was also included in general ledger accounts for non-Government-furnished property) and that contractors used questionable values for the Government-furnished property identified in CPMS. The Air Force Audit Agency (AFAA) stated that if the DFAS Denver Center had used only CPMS data and had adjusted it to known Government-furnished property in other general ledger accounts, the reported amounts would have more accurately reflected Government-furnished property. The AFAA recommended that the DFAS Denver Center:

- o establish a team to evaluate procedures for reporting Government-furnished property;
- o obtain values for Government-furnished property from DLA, using all property categories and all contract purpose codes in CPMS;
- o establish the additional general ledger accounts necessary to reconcile with CPMS data;
- o work with DLA to correct valuation inconsistencies for aircraft; and
- o make a prior-period adjustment for the FY 1996 Air Force general fund, using adjusted CPMS data to increase the Government-furnished property reported in the financial statements.

DFAS agreed that the reporting of Government-furnished property is a long-standing DoD problem, and generally agreed with the intent of the recommendations. However, DFAS stated that the issues should be addressed to the Air Force and the Office of the Secretary of Defense for overall resolution. Although DFAS felt that they should not take the lead, they agreed that their role in the process was pivotal and stated that they would work on a team whose objective was to resolve the problem.

Project 95053002, "Review of Property, Plant, and Equipment, FY 1995 Air Force Consolidated Financial Statements," concluded that the property, plant, and equipment balance in the FY 1995 Air Force consolidated financial statements could not be validated. However, the auditors identified a total of

## Appendix B. Summary of Prior Coverage

---

\$1.86 billion in recording errors and a net understatement of \$633.4 million. The Air Force did not value military equipment and vehicles reported in the September 30, 1995, Air Force financial statements in accordance with applicable accounting standards. In addition, the report stated that a \$914.2 million prior-period adjustment was needed to correct the double-counting of engine modules. The findings in the report were closely related to findings and recommendations in prior audit reports; therefore, this report made no recommendations requiring additional action.

Project 94064003, "Government Property in the Possession of Service Contractors," August 7, 1995, concluded that Air Force PAs at 9 of the 10 installations reviewed did not have adequate oversight of Government-furnished property provided to contractors. In addition, contracting officers for 14 of 26 contracts reviewed did not verify the accuracy of the data submitted by contractors on their DD Forms 1662 for FYs 1993 and 1994. Consequently, 24 of the 49 forms reviewed from FYs 1993 and 1994 contained mathematical errors and inappropriate reporting of Government-furnished property. As a result, the amounts included in CPMS were overstated by at least \$223.6 million. The AFAA recommended that the Assistant Secretary of the Air Force (Acquisition) issue instructions requiring reviewers at major commands and installations to increase their attention to the accuracy of DD Forms 1662 and provide explanatory notes. The notes should clearly state that contractors should not report real property and base supply stock, and should state whether reporting Government-furnished property is appropriate when the Air Force maintains accountable property records. The Assistant Secretary of the Air Force (Acquisition) concurred with the recommendations and agreed to implement them by August 31, 1995.

---

## **Appendix C. Federal and DoD Regulations on Government Property**

Several regulations address Government-furnished property. A brief description of those regulations is provided below.

**Federal Acquisition Regulation (FAR) part 45, "Government Property,"** prescribes policies and procedures for providing Government property to contractors; for contractors' use and management of Government property; and for reporting, redistributing, and disposing of contractor inventory.

**Defense Federal Acquisition Regulation part 252.245-7001, "Reports of Government Property,"** requires each contractor to provide an annual report prepared in accordance with DD Form 1662, "DoD Property in the Custody of Contractors," to the Government PA no later than October 31. The data are reported as of September 30.

**DoD 7000.14-R, the "DoD Financial Management Regulation," volume 1, "General Financial Management Information, Systems, and Requirements," May 1993,** prescribes the DoD Uniform Chart of Accounts that is required for DoD accounting systems for all appropriations and funds. The DoD Uniform Chart of Accounts forms the structure of the DoD Standard General Ledger. The DoD Standard General Ledger is based on the U.S. Government Standard General Ledger.

**DoD 7000.14-R, volume 4, "Accounting Policy and Procedures," January 1995,** sets forth the standards to be followed in accounting for assets. DoD accounting systems shall include Government-furnished property data listed by contractor. DoD accounting records shall contain the value of Government-furnished property shipped or otherwise furnished to contractors, as well as Government-furnished property reported by contractors as used, returned, lost, damaged, destroyed, sold, purchased, retained through nonreimbursable transfer of title, or shipped to a third party.

**DoD 7000.14-R, volume 11B, "Reimbursable Operations, Policy and Procedures - Defense Business Operations Fund (DBOF)," December 1994,** sets forth the financial management requirements and functions of all Defense Business Operations Fund activities. Chapter 57 describes the purpose, contents, valuation basis, and accounting policies and procedures for "Work in Process" and "Construction in Progress" accounts.

**DoD Directive 4161.2, "Acquisition, Management, and Disposal of Government-Owned Contract Property," December 31, 1991,** states the DoD policy that contractors are ordinarily required to furnish all property necessary to perform Government contracts. However, if contractors request or are provided Government property, the DoD Components are to ensure compliance with the FAR.

## **Appendix C. Federal and DoD Regulations on Government Property**

---

**DoD 4161.2-M, "DoD Manual for the Performance of Contract Property Administration,"** December 1991, sets forth the policies and procedures that PAs use in monitoring contractors' management of Government property.

**DoD Instruction 5010.38, "Internal Management Control Program,"** April 14, 1987, requires management to establish, monitor, and report on a comprehensive management control system.

## Appendix D. Categories of Government Property as Reported in CPMS

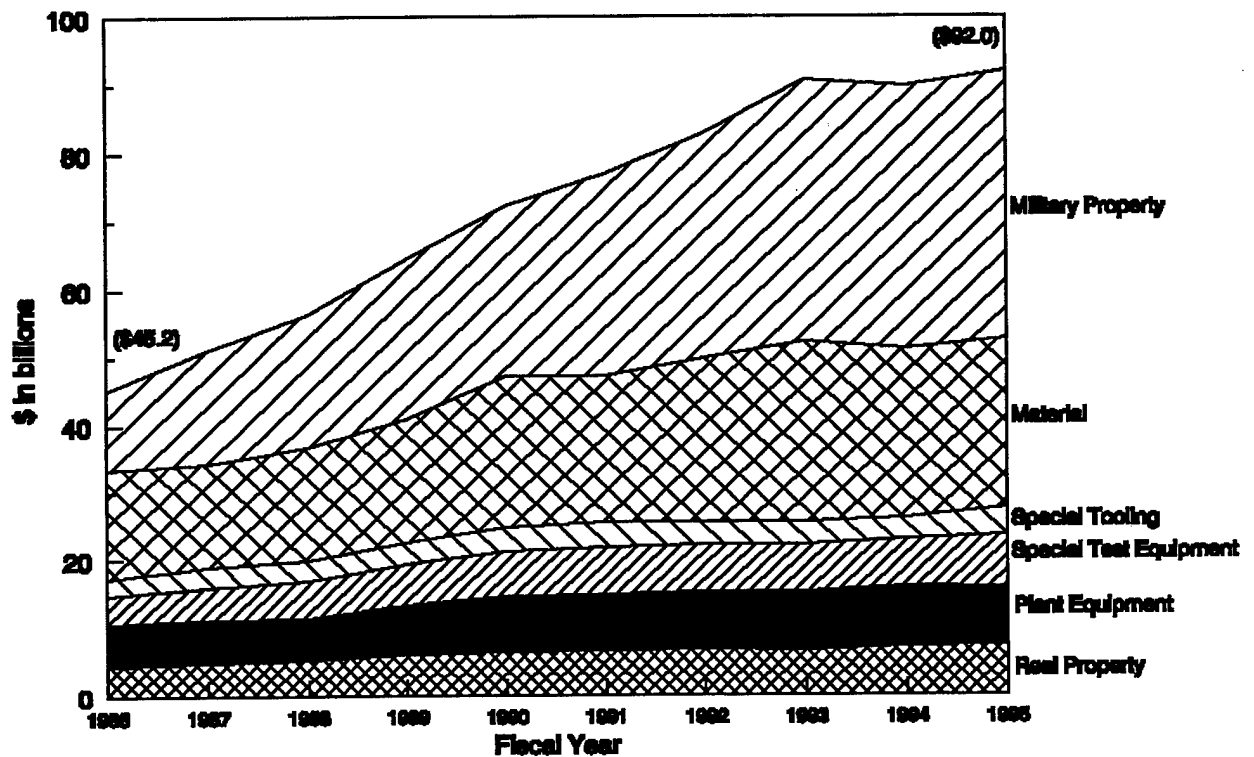
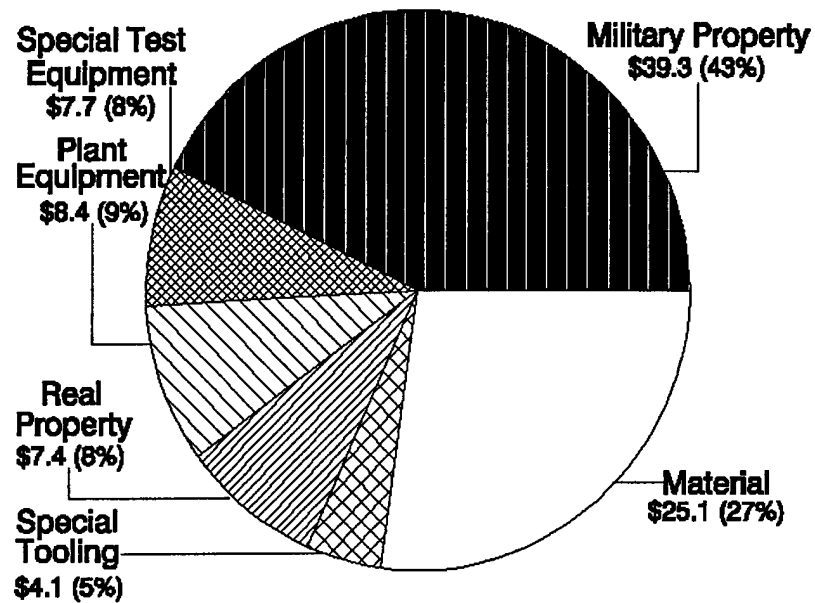


Figure D-1. Government Property Reported in CPMS has Doubled Since FY 1986

## Appendix D. Categories of Government Property as Reported in CPMS

---



**Figure D-2. Government Property Reported in CPMS as of September 30, 1995**



# Appendix E. DD Form 1662, "DoD Property in the Custody of Contractors"

<b>DOD PROPERTY IN THE CUSTODY OF CONTRACTORS</b> (DFARS 24.505-14) <i>(See instructions on back before completing this form.)</i>				REPORT AS OF 30 SEP 93 OR _____		Form Approved OMB No. 0704-0246 Expires Dec 13, 1996 REPORT CONTROL SYMBOL	
<small>Public reporting burden for this collection of information is estimated to average 1 hour per response, including the time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. Send comments regarding this burden estimate or any other aspect of this collection of information, including suggestions for reducing this burden, to Washington Headquarters Services, Directorate for Information Operations and Reports, 1215 Jefferson Davis Highway, Suite 1204, Arlington, VA 22202-4302, and to the Office of Management and Budget, Paperwork Reduction Project (0704-0246), Washington, DC 20503.</small>							
<b>PLEASE DO NOT RETURN YOUR COMPLETED FORM TO EITHER OF THESE ADDRESSES.          RETURN COMPLETED FORM TO THE ADDRESS IN ITEM 1</b>							
1. TO (Enter name and address of property administrator)				2. FROM (Enter full name, address and CAGE code of contractor)			
3. IF GOVERNMENT-OWNED, CONTRACTOR-OPERATED PLANT, ENTER GOVERNMENT NAME OF PLANT							
4. CONTRACT NO. (PIN)		5. CONTRACT PURPOSE	6. BUSINESS TYPE (L, S, or N)	7. OFFICIAL NAME OF PARENT COMPANY			
8. PROPERTY LOCATION(S)				9. PLANT EQUIPMENT PACKAGE (PEP No. and use)			
a. PROPERTY (Type of Account)	b. BALANCE START OF PERIOD		c. ADDITIONS (in dollars)	d. DELETIONS (in dollars)	e. BALANCE END OF PERIOD		
	(1) ACQUISITION COST (in dollars)	(2) QUANTITY (in units or acres)			(1) ACQUISITION COST (in dollars)	(2) QUANTITY (in units or acres)	
10. LAND							
11. OTHER REAL PROPERTY							
12. OTHER PLANT EQUIPMENT							
13. INDUSTRIAL PLANT EQUIPMENT							
14. SPECIAL TEST EQUIPMENT							
15. SPECIAL TOOLING (Government Title Only)							
16. MILITARY PROPERTY (Agency - Peculiar)							
17. GOVERNMENT MATERIAL (Government - Furnished)							
18. GOVERNMENT MATERIAL (Contractor - Acquired)							
19. CONTRACTOR REPRESENTATIVE							
a. TYPED NAME (Last, First, Middle Initial)			b. SIGNATURE		c. DATE SIGNED (YYMMDD)		
20. DOD PROPERTY REPRESENTATIVE							
a. TYPED NAME (Last, First, Middle Initial)			c. SIGNATURE		d. DATE SIGNED (YYMMDD)		
b. TELEPHONE NUMBERS (Commercial and DSN)							

DD Form 1662, DEC 93 (EG)

PREVIOUS EDITION IS OBSOLETE.

PerFORM (GLA)

# Appendix E. DD Form 1662, "DoD Property in the Custody of Contractors"

REPORTING INSTRUCTIONS	
<p><b>GENERAL.</b> The prime contractor shall report all DoD property (as indicated) in its custody or in that of its subcontractors as of September 30 to the Government Property Representative by October 31 of each year. Also report zero end of period balances when no DoD property remains accountable to the contract. Report data from records maintained in accordance with FAR Subpart 45.5 and DFARS Subpart 245.5.</p>	
<p><b>REPORT AS OF 30 SEP 18</b> _____. Fill in the appropriate year for other data.</p>	
<p><b>ITEM 1 - TO.</b> Enter the name of the Government Property Representative, the Contract Administration Office or other office the Government Property Representative works for, and the full mailing address (including City, State, and ZIP+4).</p>	
<p><b>ITEM 2 - FROM.</b> Enter the full name and address of the reporting contractor with the Division name stated after the Corporate name. Use the name as it appears on the contract but omit articles and insert spaces between company names that are made up of letters like XYZ Inc., for example. Also enter the Commercial and Government Entity (CAGE) Code.</p>	
<p><b>ITEM 3 - IF GOVERNMENT - OWNED CONTRACTOR - OPERATED PLANT, ENTER GOVERNMENT NAME OF PLANT.</b> Enter the Government name of the plant if the plant is Government - owned and Contractor - operated. Leave blank if it is a contractor - owned plant.</p>	
<p><b>ITEM 4 - CONTRACT NO. (PIN).</b> Enter the 13-digit contract number or Procurement Instrument Identification Number (PIN) under which the Government property is accountable. Use format XXXXXX-XX-X-XXXX.</p>	
<p><b>ITEM 5 - CONTRACT PURPOSE.</b> Enter one of the following 1-character alphabetic codes to identify the general purposes of the contract:</p> <ul style="list-style-type: none"> <li>A. RDT&amp;E</li> <li>B. Supplies and Equipment (deliverable and items)</li> <li>C. Facilities Contract</li> <li>D. Lease of facilities by the contractor</li> <li>E. Maintenance, Repair, Modification, or Rebuilding of Equipment</li> <li>F. Operation of a Government - Owned Plant or Facilities including test sites, ranges, installations</li> <li>G. Service contract performed primarily on Military installations, test facilities, ranges or sites</li> <li>H. Contract for storage of Government Property</li> <li>I. Others</li> </ul>	
<p><b>ITEM 6 - BUSINESS TYPE.</b> Enter a 1-character alphabetic code indicating the type of business concern:</p> <p>L = Large      S = Small      N = Non-profit</p>	
<p><i>(See FAR Part 19 for definition of Small Business and FAR 31.701 for definition of Non-profit Organizations.)</i></p>	
<p><b>ITEM 7 - OFFICIAL NAME OF PARENT COMPANY.</b> Enter the name of the Parent Corporation of the Reporting Contractor. The Parent Corporation is one in which common stock has been issued whether or not the stock is publicly traded and which is not a subsidiary of another corporation.</p>	
<p><b>ITEM 8 - PROPERTY LOCATION(S).</b> Enter the primary location(s) of the property if it is located at site(s) other than that of the Reporting Contractor, e.g., location of subcontract property or property at alternate sites of the prime contractor. Location is the City, State and Zip or the Military Installation or the Foreign site. Limit input to 69 characters. NOTE: Can be used as a "REMARKS" field.</p>	
<p><b>ITEM 9 - PLANT EQUIPMENT PACKAGE.</b> Enter the Number and Use of a Plant Equipment Package (PEP) if one exists on this contract. Leave blank otherwise. Example: ARMY PEP #570 - B1 mm Shells.</p>	
<p><b>ITEM 10 - 15.a.(1) - ACQUISITION COST (BALANCE AT THE BEGINNING OF THE FISCAL YEAR).</b> Enter the acquisition cost for each type of property as defined in FAR 45.5 or DFARS 245.5. The amounts reported must agree with the amounts reported in the previous year for BALANCE AT END OF PERIOD.</p>	
<p><b>ITEM 10, 12 - 15.a.(2) - QUANTITY (BALANCE AT BEGINNING OF THE FISCAL YEAR).</b> Enter the quantity for all categories of Government property except for Other Real Property and Material on hand at the beginning of the fiscal year. The amounts reported must agree with the amounts reported in the previous year for BALANCE AT END OF PERIOD.</p>	
<p><b>ITEM 10 - 15.b. - ADDITIONS (in dollars).</b> For the property categories indicated, enter the acquisition cost for the total additions to the contract from any sources during the fiscal year. Do not enter for Government Material or Military Property.</p>	
<p><b>ITEM 10 - 15.c. - DELETIONS (in dollars).</b> For the property categories indicated, enter the acquisition cost for the total deletions from the contract during the fiscal year. Do not enter for Government Material or Military Property.</p>	
<p><b>ITEM 10 - 15.a.(1) - ACQUISITION COST (BALANCE AT THE END OF FISCAL YEAR).</b> Enter the acquisition cost for each type of property as defined in FAR 45.5 or DFARS 245.5.</p>	
<p><b>ITEM 10, 12 - 15.a.(2) - QUANTITY (BALANCE AT END OF FISCAL YEAR).</b> Enter the quantity of all categories of Government Property except for Other Real Property and Material on hand at the end of the fiscal year. These will be carried forward to reflect the balance at the beginning of the following year.</p>	
<p><b>ITEMS 17 and 18 - GOVERNMENT MATERIAL.</b> Report material as reflected on inventory records in accordance with FAR 45.505-3.</p>	
<p><b>ITEM 19 - CONTRACTOR REPRESENTATIVE.</b> Type the name of the contractor representative authorized by the property control system to sign this report.</p>	
<p><b>ITEM 20 - DOD PROPERTY REPRESENTATIVE.</b> Type the name of the DoD Property Administrator or other Authorized Property Representative, plus that individual's commercial area code and telephone number and DSN number (if one exists). Signature and date.</p>	
<p><b>NOTE TO CONTRACTOR:</b> When reporting more than one contract from the same location and the same contractor, you may elect to fill out Data Elements 1, 3, 6, 7, and 19 only once as long as each form can be readily identified if any form becomes separated from the others.</p>	

DD Form 1662, DEC 93, (BACK) (REV)

# Appendix F. Topic Four, "Financial Accounting for Government Property in the Possession of Contractors"

## **TOPIC FOUR** **Financial Accounting for Government Property in the Possession** **of Contractors (GPPC)**

### **Background**

The Chief Financial Officers (CFO) Act requires Federal Departments and independent Agencies to annually produce Financial Statement. One of the elements of these Financial Statements is accounting for Federally-owned Property, Plant and Equipment (PP&E).

The Statement of Federal Financial Accounting Standards (SFFAS) for PP&E provides for four categories of PP&E:

- General PP&E
- Federal Mission assets
- Heritage assets
- Stewardship land

General PP&E is reported on the "Balance Sheet." Only assets whose acquisition costs exceed the Capitalization Threshold are included<sup>1</sup>. The reported valuation is the depreciated value of each asset. The other three categories of PP&E are reported on a separate "Stewardship Report." Assets reflected in the Stewardship Report are reported regardless of acquisition cost, and the reported valuation is the acquisition cost.

The Government's property records for GPPC normally are maintained by the contractors that have custody of the property. Each item of government property is accounted for separately, regardless of acquisition cost; and the valuation of each item on the property record is its acquisition cost. Currently, government property is in the possession of contractors at over four thousand locations. Many of the contractor's "property books" are automated; using contractor-selected, commercially-available property management software.

Each contractor having custody of government property is required to annually submit a report of the government property, using DD Form 1662, summarizing the quantity and acquisition cost by type of property of the property in its possession on September 30. The 1662 report contains data fields for nine types of property [e.g., industrial plant equipment, special tooling, etc.]. Each 1662 report is identified as reflecting one of nine "contract purposes" [e.g., production of supplies and equipment, etc.].

<sup>1</sup> The Capitalization Threshold currently is \$100K. However, the threshold has been raised several times over the years in recognition of the impact of inflation.

## **Appendix F. Topic Four, "Financial Accounting for Government Property in the Possession of Contractors"**

---

A separate report is submitted for each contract. Currently, report submission is not automated. At the end of FY 1996, there were 14,500 contracts involving government property in the custody of contractors.

The Contractor Property Management System (CPMS) is a database and management report generator maintained by the Defense Contract Management Command (DCMC) which contains only the information submitted on the 1662 reports. Thus, the data in the CPMS can provide information on the aggregate acquisition cost of property in the possession of contractors by purpose of contract and type of property—making CPMS a management information source; not a property accountability system.

Recent audits have addressed the reliability of CPMS data and reported that CPMS is not a complete and accurate source of information on GPPC, and that CPMS does not provide information adequate for audited DoD financial statements. Therefore, the IPT is not recommending that CPMS be the long-term solution to the financial reporting problem. The CPMS data should only be used until a financial reporting system is established that meets CFO requirements for auditable financial statements. In the near-term however, not using CPMS data for some GPPC would mean that nothing would be reported in the financial statements because no other data exists.

### **IPT's Observations & Recommendations**

The nine property types reported in the CPMS can be grouped into four general categories: Military Property, Real Property, Material, and Tooling and Equipment. The recommended treatment of each of these categories for the Financial Statement is described below and portrayed in the attached table.

#### **Military Property**

Military Property [e.g., aircraft, tracked vehicles, C3I equipment, etc.] is reported in the CPMS because custodial records are maintained for these items while they are in a contractor's possession in order to document the contractor's accountability. However, this type of property is (or should be) also on the property records of some DoD organization. Thus, in order to avoid duplicate financial reporting, CPMS data should not be used to report Military Property on Financial Statements.

#### **Real Property**

Real Property in the custody of contractors is reported in the CPMS. However, property accountability records for this property also exist in the Services' Real Property Accountability systems. In order to avoid duplicate financial reporting, CPMS data should not be used to report Real Property on Financial Statements. The

## Appendix F. Topic Four, "Financial Accounting for Government Property in the Possession of Contractors"

Services have indicated that the CPMS is not the source for Real Property currently being reported in Financial Statements.

### Material

Material in the custody of contractors consists of Contractor Acquired Material (CAM) and Government-Furnished Material (GFM). GFM is a combination of: items produced by a "prime" sub-system contractor and shipped at DoD's direction to a "prime" systems integration contractor; items obtained from DoD's wholesale supply system via a MILSTRIP transaction; and, items acquired or fabricated by a contractor to which the government has obtained title and subsequently furnished to a contractor for performance of a government contract.

Material is property which will either be consumed in the course of contract performance or incorporated into an end item. As such, "material" does not meet one of the key criteria for being classified as PP&E—namely the property does not have an estimated useful life [as a separately identifiable item] of two or more years.

The closest analog for material in the possession of contractors among the various entries on the Balance Sheet is "Operating Materials and Supplies." Inventories of Operating Materials and Supplies in the custody of government personnel are reported at "Last Acquisition Cost" on the Balance Sheet. This valuation method is analogous to the valuation used for Material in the CPMS. Thus, it would appear reasonable to reflect Material reported in the CPMS as Operating Materials and Supplies on the Balance Sheet.

### Tooling and Equipment

The convention being used for Financial Accounting of equipment in the possession of government employees is that purpose for which the equipment exists, not equipment type, determines where the equipment gets categorized. In other words, a general purpose machine tool located on an aircraft carrier, and thus on the carrier's property books, would be considered to be a Federal Mission asset, and thus be accounted for in the Stewardship Report. The determinant for treatment in the Financial Statements of government-provided tooling and equipment possessed by contractors should be contract "purpose," not equipment type.

Contrary to conventional wisdom, contractors possess tooling and equipment for reasons other than developing and manufacturing weapon systems and other military equipment and supplies. Where government tooling and equipment being used by contractors is being used for purposes that are identical to functions performed by government personnel, then the Financial Statements should treat these situations similarly, if doing so can be done without extraordinary expenditures merely to produce requisite data.

## Appendix F. Topic Four, "Financial Accounting for Government Property in the Possession of Contractors"

There are two CPMS "purpose" categories where the property in that category is in the possession of contractors solely because the government made an explicit decision to outsource some activity; i.e., Operation of a Government Plant or Facility [Purpose F] and Base Services [Purpose G]. For consistency with the treatment of PP&E in the custody of government employees, these two categories should be reflected in "General PP&E" in the Financial Statements. This will require each Military Department's Contract Property Administration community to implement a means of providing information on the depreciated valuation of reportable assets to the Financial Management community. This can be done without a major revision to the entire GPPC property accountability and reporting system, because:

- There are less than 60 contracts with Purpose category F reported in CPMS.
- Although there are about 900 Base Services contracts in CPMS, it is unlikely that many of these contracts contain items of equipment that are reportable<sup>2</sup>.

The overwhelming preponderance [about 85%] of the tooling and equipment in the possession of contractors for purposes other than Base Services and Operation of Plants or Facilities, is there solely to permit the development and/or manufacture of weapon systems, other types of military equipment, or other military supplies<sup>3</sup>. Including Maintenance and Repair of Equipment contracts increases this to over 95%. The items that are produced or repaired with this tooling and equipment are categorized as either Federal Mission PP&E or Inventory for financial accounting purposes—with Federal Mission constituting the lion's share of the asset valuation.

One of DoD's objectives must be to implement the requirements of the CFO Act in such a way that non-value added expenditures of resources are avoided wherever possible. Consequently, the IPT recommends that, for CPMS contract "purposes" other than the two described above, tooling and equipment be treated as Federal Mission assets in the Financial Statements<sup>4</sup>. This may avoid the need to implement an entirely different property accountability and reporting system—not needed to carry out the requirements of the Federal Property and Administrative Services Act nor the Federal Acquisition Regulation—at over 4,000 contractor facilities.

<sup>2</sup> Items of Property, Plant, and Equipment (PP&E) valued at less than the Capitalization Threshold are not reported in the General PP&E category.

<sup>3</sup> The vast bulk of the remainder is associated with the 3,400 Maintenance and Repair of Equipment contracts or the 860 "Other" contracts reported in the CPMS.

<sup>4</sup> A modification to the CPMS, and perhaps the property records and 1662 report, will be necessary to permit distinguishing between "direct fund" and "revolving fund" sources.

### 4 TOPIC FOUR

## Appendix F. Topic Four, "Financial Accounting for Government Property in the Possession of Contractors"

---

The IPT recognizes that this Tooling and Equipment does not meet the criteria for Federal Mission Assets prescribed in the relevant Statement of Federal Financial Accounting Standards (SFFAS); i.e., Number 6, "Accounting for Property, Plant, and Equipment," and Number 8, "Supplementary Stewardship Reporting". As the SFFASs are written today, Federal Mission PP&E is limited to weapons systems. Paragraph 50 of SFFAS number 6 states, " 'Weapons systems' are a combination of one or more weapons with all related equipment, materials, services, personnel and means of delivery and deployment [emphasis added] required for self-sufficiency. This standard addresses only the PP&E component [emphasis added] of weapons systems. ...intended to be used directly by the armed forces to carry out combat missions, when necessary, and to train in peacetime."

The Federal Accounting Standards Advisory Board (FASAB) is entertaining technical changes to both SFFAS numbers 6 and 8. The IPT believes that this provides DoD with the opportunity to include GPPC in the Federal Mission PP&E category for financial reporting. The definition of weapons systems will need to be revised to allow property that is not deployable and is not a component of a weapon system to be included. Alternatively, GPPC could be reported as a separate category on the supplementary Stewardship Report. The benefit of either of these changes will be to minimize or eliminate non-value added expenditures of resources to satisfy financial reporting requirements that were developed without consideration of the impact on DoD operations.

### **Recapitulation of Recommendations**

Data reported in the CPMS should be reflected in the Financial Statement as follows:

1. Report Material on the Balance Sheet as Operating Materials and Supplies
2. Report Tooling and Equipment associated with Base Services and Operation of Facilities contracts on the Balance Sheet as General Property, Plant & Equipment
3. Report Tooling and Equipment associated with all other contract "purposes" in the Stewardship Report as Federal Mission PP&E, or as a separate category

---

## **Appendix G. Report Distribution**

### **Office of the Secretary of Defense**

Under Secretary of Defense for Acquisition and Technology  
    Director, Defense Procurement  
    Director, Defense Logistics Studies Information Exchange  
Under Secretary of Defense (Comptroller)  
    Deputy Chief Financial Officer  
    Deputy Comptroller (Program/Budget)  
Assistant Secretary of Defense (Public Affairs)  
Deputy Under Secretary of Defense (Industrial Affairs and Installations)

### **Department of the Army**

Secretary of the Army  
Auditor General, Department of the Army

### **Department of the Navy**

Secretary of the Navy  
Assistant Secretary of the Navy (Financial Management and Comptroller)  
Auditor General, Department of the Navy

### **Department of the Air Force**

Secretary of the Air Force  
Assistant Secretary of the Air Force (Financial Management and Comptroller)  
Auditor General, Department of the Air Force

### **Other Defense Organizations**

Director, Defense Finance and Accounting Service  
Director, Defense Contract Audit Agency  
Director, Defense Logistics Agency  
    Commander, Defense Contract Management Command



## **Other Defense Organizations (cont'd)**

Director, National Security Agency  
Inspector General, National Security Agency  
Inspector General, Defense Intelligence Agency

## **Non-Defense Federal Organizations**

Office of Management and Budget  
Technical Information Center, National Security and International Affairs Division,  
General Accounting Office

Chairman and ranking minority member of each of the following congressional committees and subcommittees:

Senate Committee on Appropriations  
Senate Subcommittee on Defense, Committee on Appropriations  
Senate Committee on Armed Services  
Senate Committee on Governmental Affairs  
House Committee on Appropriations  
House Subcommittee on National Security, Committee on Appropriations  
House Committee on Government Reform and Oversight  
House Subcommittee on Government Management, Information, and Technology,  
Committee on Government Reform and Oversight  
House Subcommittee on National Security, International Affairs, and Criminal  
Justice, Committee on Government Reform and Oversight  
House Committee on National Security

## **Audit Team Members**

This report was produced by the Finance and Accounting Directorate, Office of the Assistant Inspector General for Auditing, DoD.

F. Jay Lane  
Richard B. Bird  
Linda A. Pierce  
Lisa A. Ramseyer  
Joseph E. Wolski  
Laura J. Croniger  
Mark A. Krulikowski  
William E. Hosick  
Susanne B. Allen

## INTERNET DOCUMENT INFORMATION FORM

**A . Report Title: Financial Reporting of Government Property in the Custody of Contractors**

**B. DATE Report Downloaded From the Internet: 10/13/99**

**C. Report's Point of Contact: (Name, Organization, Address, Office Symbol, & Ph #):**  
OAIG-AUD (ATTN: AFTS Audit Suggestions)  
Inspector General, Department of Defense  
400 Army Navy Drive (Room 801)  
Arlington, VA 22202-2884

**D. Currently Applicable Classification Level: Unclassified**

**E. Distribution Statement A: Approved for Public Release**

**F. The foregoing information was compiled and provided by:**  
DTIC-OCA, Initials: \_\_VM\_\_ Preparation Date 10/13/99

The foregoing information should exactly correspond to the Title, Report Number, and the Date on the accompanying report document. If there are mismatches, or other questions, contact the above OCA Representative for resolution.

19991013 133